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No. 85-554

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

UNITED STATES OF AMERICA,
Petitioner,

v.

HUGHES PROPERTIES, INC.,
Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Federal Circuit

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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I

QUESTION PRESENTED

Whether the Court of Appeals correctly determined that Hughes Properties, Inc., an accrual basis taxpayer engaged in the business of gaming, may deduct for federal income tax purposes its accrued but unpaid liability for progressive slot machine jackpots.

PARTIES

Petitioner is the United States of America. Respondent is Hughes Properties, Inc., which does not have a parent company, subsidiaries (except for Harolds Club, Inc., a wholly owned inactive subsidiary), or any affiliates.

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Respondent Hughes Propertes, Inc. respectfully prays that the Petition for Writ of Certiorari to review the judgment and opinion of the United States Court of Appeals for the Federal Circuit entered in this action on May 2, 1985 be denied.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved in this case that are not set forth in the statutory appendix to the Petition for Certiorari are Section 1.446-1(c)(1)(ii) of the Treasury Regulations on Income Tax (26 C.F.R.), Section 463.310 of the Nevada Revised Statutes, and Section 5.110 of the Nevada Gaming Regulations and are included in the appendix (App., *infra,* 1a-5a).

STATEMENT OF THE CASE

Additional facts of the case that clarify and supplement the factual summation set forth in the Petition for Certiorari may be summarized as follows:

During the taxable years in issue, respondent owned and operated various types of progressive slot machines. Those machines differed as to the number and value of coins that can be gambled by a customer and the number and size of the reels contained within a machine. Because of the differences in types of machines, the odds of winning a "guaranteed" jackpot vary. The average period between payoffs is approximately 4.5 months (Pet. App. 6-7a). All of respondent's accrued but unpaid progressive slot machine jackpots as of June 30, 1977, the close of the last taxable year in issue, were subsequently won by and paid to customers of respondent (C.A. App. 113).

The Nevada Gaming Commission, which promulgated Nevada Gaming Regulation § 5.110, strictly enforces Regulation § 5.110. Section 463.310 of the Nevada Revised Statutes ("N.R.S.") authorizes the Nevada Gaming Commission to impose severe administrative sanctions (including license revocation and fines up to $100,000)

upon any licensed gaming establishment that wrongfully refuses to pay a winning customer a "guaranteed" jackpot. Once accumulated, a "guaranteed" jackpot cannot be reduced or eliminated except by a payoff (Pet. App. 9a).

The meter readings on its progressive slot machines that respondent recorded daily in accordance with Nevada Gaming Regulation § 5.110 provided the numerical data for the deductions taken by respondent. The accrued but unpaid progressive slot machine jackpot amounts as reported by the respondent from 1973 to 1977 were:

Fiscal Year Ended June 30	*Accrued Liability*	*Deduction (Income)*
1973	$360,228.55	$360,228.55
1974	563,983.99	203,755.44
1975	853,584.22	289,600.23
1976	839,400.97	(14,183.25)
1977	888,820.67	49,419.70

(Pet. App. 9a).

Respondent deducted as an ordinary and necessary business expense under Section 162 of the Code[1] the net accrued liability for each fiscal year. The net accrued liability is determined by subtracting the previous year's accrued liability, which has already been deducted, from the current gross liability as indicated by the meter totals. For example, on the last day of fiscal year 1974, respondent's accountants totaled the figures appearing on the meters of the progressive slot machines and determined that their gross liability for that fiscal year was $563,983.99. Because respondent had already deducted

1. Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended and as in effect for the tax years at issue (the "Code").

$360,228.55 as a business expense in the previous fiscal year, the net accrued liability was $203,755.44. This is the amount that respondent reported as a deduction on its income tax for fiscal year 1974 (Pet. App. 10a).

Although there was no dispute as to the accuracy of the amounts deducted by the respondent, the Commissioner claimed that the "guaranteed" jackpot payoffs could only be deducted in the year actually paid because the "guaranteed" jackpot amounts were merely a contingent liability (Pet. App. 10a). The Commissioner determined a deficiency in respondent's income tax in the amount of $433,441.88 for the tax years in issue (Pet. App. 1a). Respondent sought a refund after paying the assessed taxes and asserted that the accrued expense deductions were timely because the liability was fixed by Nevada state law. After respondent's request for a refund was denied, suit was instituted (Pet. App. 10a).

The Claims Court noted that petitioner "does not contest the deductibility per se of [respondent's] liability for the guaranteed jackpot amounts, but rather takes issue with the timing of those deductions" (Pet. App. 11a) (original quotation marks omitted). Petitioner "specifically rejects [respondent's] argument that the jackpot liability was fixed," the Claims Court stated, *"despite admitting that [respondent] is precluded from avoiding payment as a result of Nevada Gaming Commission Regulation § 5.110"* (Pet. App. 12a) (emphasis added). The Claims Court held:

> [A]t the end of [respondent's] fiscal year, [respondent's] obligation to pay out the recorded amount is "unconditionally fixed" by the terms of § 5.110. Under that regulation, the liability for the jackpot amount can be enforced by the Nevada Gaming Commission. . . . That the identity of that fortunate gambler is unknown, that the exact time the jackpot will be won is unknown, or that the exact amount of the jackpot at the time it is won is unknown does not affect the certainty of the liability at the end of [respondent's] fiscal year. . . . In the fact setting before the court, the uncertainties listed above do not destroy the initial certainty of liability.

Pet. App. 14a.

The Claims Court further observed that, "were the actual winning handle pull held to be the last event necessary to satisfy the all events test, the effect of such a holding would be to convert [respondent], at least in this instance, from, an *accrual* basis taxpayer to a *cash* basis taxpayer" (Pet. App. 14-15a). The Claims Court acknowledged that it "will not hesitate to uphold the Commissioner's efforts to eradicate fraudulent practices, but, where no such practice has been alleged or proven and where the court has found that the timing of the deduction does not distort income, the court will not act on mere speculation" (Pet. App. 17a). Therefore, the Claims Court held that "the liability is *unconditionally fixed* by § 463.310 of the Nevada Revised Statutes which gives full force and effect to Nevada Gaming Regulation § 5.110" (Pet. App. 18a-19a) (emphasis in original).

The Court of Appeals "reexamined those arguments, the briefs, statutes, regulations, and authorities and conclude[d] that the [Claims Court] was legally correct when it granted summary judgment to the taxpayer" (Pet. App. 3a).

REASONS FOR DENYING THE WRIT

Petitioner and respondent agree that progressive slot machine jackpots are ordinary and necessary expenses in carrying on the trade or business of gaming and are deductible under Code Section 162. The present case involves the straightforward application of the well established "all events" test which was first formulated by the Supreme Court in *United States v. Anderson,* 269 U.S. 422 (1926), and subsequently adopted by Treasury Regulation § 1.461-1(a)(2). Petitioner and respondent do not disagree with respect to the legal concept governing this case. However, the parties do disagree over the issue of whether the operative facts which establish the existence of a liability have occurred. The disagreement over these facts, however, raises no "special and important reasons" for granting certiorari as required by Supreme Court Rule 17.

The obligation for accrued jackpots is a fixed liability and the winning pull of the handle of the progressive slot machine determines solely the time of payment of the liability and the identity of the payee. All events necessary to the determination of the fact of liability and the amount of such liability occur when the progressive slot machine is placed on the casino floor and the amount of the jackpot liability is reflected on the indicator and thereafter as the amount of the jackpot obligation increases with additional play. Until a guaranteed jackpot is paid, its guaranteed amount may only increase. An increase in a guaranteed jackpot is an event subsequent to the establishment of the respondent's liability for the initial amount shown on the meter and merely increases the amount of an existing liability.

The operative facts giving rise to the liability have already occurred at the time of accrual. The obligation for progressive slot machine jackpots is established by the Nevada Gaming Regulations, statutes, and the policies of the Nevada Gaming Commission ("Commission") and the Nevada Gaming Control Board ("Board") which are binding upon all licensed gaming establishments in the State of Nevada. Under Nevada law, the Commission regulates the activities of licensed gaming establishments in the State of Nevada, and the Board has the authority to enforce the Regulations of the Commission. Prior to September 1972, there were no Gaming Regulations pertaining to progressive slot machines. The progressive slot machine jackpots were not a fixed liability before this time because a licensee could avoid any liability by simply removing the machine from the casino floor. However, in September 1972, the Commission promulgated Regulation § 5.110 which regulates progressive slot machines and, upon the adoption of the Regulation, the liability became fixed. Regulation § 5.110 was effective for all times relevant to the taxable years in issue in this case.

Regulation § 5.110 precludes a licensed gaming establishment from avoiding payment of the liability for accrued but unpaid progressive slot machine jackpots. Under the Regulation, the amount of the liability may not be reduced until the jackpot is paid, and the machine may not be removed from the floor (except for brief repairs) without either paying the accrued jackpot or transferring the obligation for the accrued jackpot to another progressive slot machine which remains in operation.

The Board and the Commission have strictly applied the provisions of Regulation § 5.110 as making guar-

anteed jackpots fixed liabilities of the licensee. The Board requires the licensed gaming establishment to be responsible for the obligation shown on the meter and holds it accountable until the amount is actually paid (C.A. App. 126-27). Further, the policy of the Board and the Commission is, and during the taxable years at issue was, that upon any sale or other disposition of the entire gaming establishment, the liability for accrued jackpots either must be paid to customers prior to the sale of the casino or assumed by the buyer following the sale (C.A. App. 110-11, 130).

A customer of a licensed gaming establishment has administrative remedies available to force the gaming establishment to pay a gaming debt including progressive slot machine jackpots. If a gaming establishment refused to pay a gaming debt to a customer who had properly won the game, N.R.S. § 463.310.4 authorizes the Commission to impose severe sanctions, including fines and the suspension or revocation of the gaming license. As a result of the foregoing Nevada Gaming Regulations, statutes, and policies, the accrued but unpaid progressive slot machine jackpots are liabilities, and once a progressive slot machine is placed in operation on the casino floor, the progressive jackpot must remain available to the customers of the casino until the jackpot is won.

The average time of payment with respect to respondent's guaranteed jackpots has been about 4.5 months. This determination was made as of September 1, 1976, for the twenty-four 4-reel progressive slot machines then in operation. All but two of these machines were installed prior to 1974 (Pet. App. 6a-7a & n.1). (Ninety-two 3-reel machines were operated by respondent and required a significantly lower number of plays than that of the

4-reel machines resulting in a much faster payoff for these machines.) Moreover, as noted above and as petitioner is well aware from the record in the case below, *all* of the accrued but unpaid jackpots in issue in this case were actually won by and paid to customers of respondent.

Petitioner's entire case is premised on its argument that the guaranteed jackpots represent "amounts to which no one can assert any present claim and which respondent may never have to pay at all" (Pet. 7). Petitioner relies on the contorted analysis of the facts set forth by the Ninth Circuit in *Nightingale v. United States*, 684 F.2d 611 (1982), in attempting to advance its position.

The Claims Court and the Federal Circuit correctly rejected *Nightingale*. When viewed against the backdrop of cases interpreting the all events test, *Nightingale* is an aberration, is wrongly decided, and is in direct conflict with substantial judicial precedent including other Ninth Circuit authority. First, the *Nightingale* court stated that "[i]f the [casino] . . . were to close its doors and go out of business, . . . it would not owe the jackpots to anybody. This tends to show that there is no present liability" (684 F.2d at 615). The Ninth Circuit in *Nightingale* also hypothesized that the amount shown on any particular slot machine might never be won because of the inability of any patron to hit the winning combination (684 F.2d at 614).

Petitioner cannot specify a single practical way in which respondent can avoid its liability for guaranteed jackpots. Instead, petitioner focuses on the extremely remote contingencies recited above. These speculative possibilities must be disregarded for federal income tax

purposes because they are not the kind of realistic contingencies that abort satisfaction of the all events test. *Lawyer's Title Guaranty Fund v. United States,* 508 F.2d 1 (5th Cir. 1975). The court in *Zwicker Knitting Mills v. United States,* 80-2 U.S.T.C. ¶ 9832 (Ct. Cl. 1980), stated (80-2 U.S.T.C. at 85,747):

> There is considerable support for the proposition that once a liability is properly accrued, the possibility of a subsequent, unexpected event changing its absolute character or discharging payment entirely should not alter its treatment as a fixed liability during the years accrued.

In *Mooney Aircraft, Inc. v. United States,* 420 F.2d 400 (5th Cir. 1969), Mooney issued to purchasers of its airplanes "Mooney Bonds" which obligated Mooney to pay the bondholder $1,000 upon the retirement of the airplane. The Commissioner contended that the taxpayer could not deduct the bonds in the year of issuance because the obligation they represented was contingent upon the happening of a future event—retirement of the airplane—and therefore the all events test was not met. In holding that the all events test had been satisfied, the court stated at 406:

> To be sure, technically, the liability is "created" by the event of the retirement of a particular plane; if a plane lasted forever there would be no liability. But taxation has been called a "practical field", and we do not see how the technical position the Government takes is designed to further the purpose of the statute . . . [T]here is no doubt at all that the liability will occur since airplanes . . . must cease to function.

Although payment of the liability in the *Mooney* situation depended upon a future event, it did not depend

upon a future contingent event because retirement of the planes was certain. There was no contingency as to the fact of the liability itself; the only contingency related to when the liability would be paid. Thus Mooney's liability was reasonably certain in fact and satisfied the all events test, even though the court believed the event of retirement might not occur for 20 or 30 years for each plane. (However, the court did uphold the disallowance on the basis that it was an exercise of the Commissioner's power under Code § 446(b) to disallow any accounting method not clearly reflecting income. Petitioner does not contend in the present case that respondent's accounting method does not clearly reflect income.)

A certain quantum of reasonableness is implicit in the application of the all events test. Treasury Regulation § 1.461-1(a)(2) does not require that respondent prove the *impossibility* of the occurrence of such subsequent events that might extinguish or reduce the amount of an existing liability. Such a requirement would indeed be anomalous. Obviously, any time an accrual basis taxpayer incurs a liability to make payments in the future, the actual payment will be subject to the contingency of ceasing to do business. Petitioner's contention that such a contingency is sufficient to prevent the accrual of expenses effectively prohibits any business establishment from utilizing the accrual method which is expressly permitted by Code § 446(c)(2) because any business can cease its operations.

Further, the concerns expressed by the Ninth Circuit in *Nightingale* and urged by petitioner here misstate the consequences. Under the tax benefit rule, even if one of the remote possibilities cited by petitioner were ever to materialize, the resulting discharge of the liability for

the guaranteed jackpots would result in income recognition by respondent in an amount equal to the amount of the accrued liability discharged. *See* Code § 61(a); *Hillsboro National Bank v. Commissioner*, 457 U.S. 1103 (1983). Therefore, no windfall expense deduction will be possible for an accrual basis taxpayer. The fact that respondent would be required to recognize the accrued liability as income if the remote possibility of avoiding payment ever materialized was an important consideration in the decision of the Claims Court (Pet. App. 15a).

In *Nightingale*, the Ninth Circuit failed to even cite its decision in *Flamingo Resort, Inc. v. United States*, 664 F.2d 1387 (9th Cir. 1982), *cert. denied*, 459 U.S. 1036 (1982). In *Flamingo Resort*, the Ninth Circuit held that an accrual basis Nevada casino must accrue as income the gaming "markers" representing customers' accounts receivable for which there exists a "reasonable expectancy" of collection. The Ninth Circuit stated that "[t]he debts which the markers' represent are, therefore, fixed; there is a reasonable expectancy of collection; and no contention has been made that the amounts cannot be determined with reasonable accuracy" (*id.* at 1390). The gaming markers in *Flamingo Resort* were not legally enforceable obligations in the State of Nevada or in any other state. Neither the two parties involved in the marker transaction nor any governmental authority could enforce the obligation represented by the markers.

The case for accrual in the present situation is far more compelling in *Flamingo Resort* because the guaranteed jackpot liability is enforceable in Nevada by the Board and Commission. In the present case, the facts establish that an accrued liability exists, and the exact amount of the liability is shown on the jackpot indicator.

Applying the Ninth Circuit's test and the Commissioner's position in *Flamingo Resort* to the present case results in a conclusion that the unpaid progressive slot jackpots can be accrued and deducted. This is so because here, as in *Flamingo Resort*, the accrued but unpaid progressive slot machine jackpot liability is fixed; there is a reasonable expectancy of payment; and no contention has been made that the amount cannot be determined with reasonable accuracy.

The practical effect of petitioner's position in the present case, in view of *Flamingo Resort*, would be to require respondent, an accrual method taxpayer engaged in the gaming business, to report gaming expenses on the cash method while reporting gaming income on the accrual method. Therefore, a gaming taxpayer would have to accrue as income any item for which there exists a "reasonable expectancy" of payment; however, an expense item with the same "reasonable expectancy" would be deducted only when payment is actually made. Such a hybrid accounting method would be inconsistent with Code §§ 451 and 461 and would distort respondent's taxable income. Because the legal tests for the accrual of items of income and expense are identical (Treas. Reg. §§ 1.451-1(a), 1.461-1(a)(2)), and because the Ninth Circuit in *Nightingale* failed to follow (or even discuss) its rationale in *Flamingo Resort*, an irreconcilable conflict exists between the Ninth Circuit's decision in *Nightingale* and its decision in *Flamingo Resort*.

In addition, *Nightingale* ignored well-settled case law which holds that the uncertainty of the time for payment or the identity of the payee of a liability will not prevent its accrual for federal income tax purposes. The Ninth Circuit in *Nightingale* held, "[n]o one can say who will hit

the jackpot on that machine, how much it will be when he hits it, or when he will hit it. There are just too many contingencies to permit accrual of the liability as the taxpayer would have us do." 684 F.2d at 614. In situations like the guaranteed jackpots where only the time of payment and the identity of the payee are uncertain, it is the certainty of the liability which is of utmost importance in applying the all events test. *Lukens Steel Co. v. Commissioner,* 442 F.2d 1131 (3d Cir. 1971), *aff'g* 52 T.C. 764 (1969); *Cyclops Corp. v. United States,* 408 F. Supp. 1287 (W.D. Pa. 1976); *Inland Steel Co. v. United States,* 76-2 U.S.T.C. ¶ 9791 (Ct. Cl. 1976). The existence of the liability precedes the actual winning of a guaranteed jackpot, the event which merely fixes the time of payment of the liability and the identity of the payee. "The crucial point is the legal liability to pay someone at some point in time." *Reynolds Metals Co. v. Commissioner,* 68 T.C. 943, 960 (1977).

In *Washington Post Co. v. United States,* 405 F.2d 1279 (Ct. Cl. 1969), the taxpayer accrued amounts on its books for obligations to a profit incentive plan covering all of its circulation dealers. Under the vesting schedule of the plan, there existed a remote possibility that no participant would become 100 percent vested. The Commissioner argued that there was not a liability because the accrual might never actually be paid. In the alternative, the Commissioner contended that if there were a liability, the liability was not definite enough to be "fixed" under the all events test because the ultimate recipients and the time of actual payment could not be ascertained in the year of accrual. The court found that the taxpayer had irrevocably committed itself to payment of the accrued amounts and held that the "indeterminancy involved does not make the liability any less real, or any

less fixed" (*id.* at 1283). The court further held that certainty of the time of payment and knowledge of the identity of the payee are not prerequisites to accruability (*id.* at 1284). Accordingly, the all events test was satisfied and the taxpayer was entitled to the deduction.

Similarly, respondent also has irrevocably committed to pay the accrued liability for the progressive slot machine jackpots. The liability cannot be avoided. Even the extremely remote possibility which existed in *Washington Post* that no participant would be 100 percent vested does not exist here. The only unknown facts in the present case are the time of payment of the jackpot and the identity of the winning customer.

Another issue addressed by the Ninth Circuit in *Nightingale* was its concern that the casino was deducting an expense that was not being matched in the current taxable year with the income of a winning customer. The Ninth Circuit stated that "[a]nother factor of some significance is that the jackpots will not be taxable as income to any person until they are won." 684 F.2d at 615. No principle of federal income tax law states that a taxpayer may not deduct an accrued expense until a corresponding amount of income is recognized by another taxpayer. In fact, the recognition of the cash and accrual methods of accounting under Code § 446(c) contemplates that there will be timing differences between the recognition of income by one party to a transaction who is on the cash method and the recognition of expense by the other party to the transaction who is on the accrual method. In a transaction between an accrual basis taxpayer and a cash basis taxpayer, the former is obligated to recognize expenses when the all events test is satisfied, while the latter must only report income actually or

constructively received. Matching of income and expense between two different taxpayers is not required. Therefore, it is irrelevant that there is no matching of income and expense between respondent and its customers.

In rendering its opinion, the Ninth Circuit stated that *Nightingale* was "closely in point" with *Brown v. Helvering,* 291 U.S. 193 (1933). Petitioner, citing *Brown,* contends that the accrued but unpaid jackpot liabilities are nothing more than non-deductible reserves. In *Brown,* the taxpayer, an insurance broker, attempted to deduct the estimated amount of commissions which would have to be refunded in the future upon the cancellation of any of the insurance policies which were written by the taxpayer during the taxable year. None of the insurance policies from which the commission income had been derived had been cancelled as of the end of the taxable year at issue, and the taxpayer had no obligation to refund any commissions prior to the cancellation of the policies. The amount which the taxpayer attempted to deduct was merely the amount which he estimated to be refunded in the future. In *Brown,* therefore, there was no pre-existing obligation for refund of insurance premiums. The liability of the insurance company to refund premiums was contingent upon the cancellation of policies by customers. Thus the operative fact giving rise to the disputed liability in the case was the cancellation of each insurance policy, and such operative fact had not yet occurred.

In the present case, the operative facts are the initial placement of the progressive slot machine on the casino floor and each subsequent play of the machine by customers which results in an increase in the liability which cannot be avoided. Pursuant to the Regulations and

statutes, there is a fixed, pre-existing obligation to pay the jackpot because the progressive slot machine jackpots must remain on the casino floor until they are won by customers.

Finally, the Ninth Circuit in *Nightingale* stated that the allowance of the deduction would open the way "for casinos to overcome the restraints of annual accounting in a perfectly legal way. They could put extra machines on the floor on the last day of the tax year with whatever initial jackpot they chose and with whatever odds they liked. Then they could take a current deduction for the full amount even though payment of the jackpots might not occur for many years." 684 F.2d at 615. There was not even a suggestion that such tax avoidance occurred in *Nightingale* and petitioner does not allege that such an abuse has occurred in the present case. Assuming arguendo that there is a basis for such a concern, it is obviated by Code § 446(b) which provides that "[i]f the method used [to compute taxable income] does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary, does clearly reflect income." The Commissioner's broad discretion and powers under § 446 to modify a taxpayer's accounting method to insure a clear reflection of income have been consistently upheld. *See Commissioner v. Hansen,* 360 U.S. 446, 467 (1959); *Lucas v. American Code Co.,* 280 U.S. 445, 449 (1930). However, where no such practice has been alleged or proven and where the timing of the deduction does not distort income, courts have not acted on mere speculation. Therefore, although no distortion of taxable income resulted in *Nightingale* or in respondent's case, a court could in an appropriate case, disallow a deduction if such abuse were shown to have occurred.

It is the obligation established by Nevada state law that a licensee incurs to the players at the time the licensee places a progressive slot machine in operation that fixes the fact of the licensee's liability within the meaning of Treasury Regulation § 1.461-1(a)(2). The law is well established that a deductible liability can arise from a state legal requirement, and petitioner has not contended otherwise. For example, *Crescent Wharf & Warehouse Co. v. Commissioner,* 518 F.2d 772 (9th Cir. 1975), involved the accrual of an employer's liability to injured employees under workers' compensation laws. The Commissioner argued that liability was not incurred by the employer until medical attention was given to an injured employee and the employer was obligated to pay for the specific medical treatment. The Ninth Circuit held that the estimated liability of the employer for self-insured workers' compensation benefits which were payable pursuant to California law was deductible so long as the amount could be estimated with reasonable accuracy. The injury and not the payment was the event which established liability whether medical services were rendered or disability occurred at that time or in the future.

The most clearly analogous precedent establishing that for purposes of the all events test the guaranteed jackpot constitutes a liability are those cases dealing with coal strip mining operations. *See Denise Coal Co. v. Commissioner,* 271 F.2d 930 (3d Cir. 1959); *Harrold v. Commissioner,* 192 F.2d 1002 (4th Cir. 1951). *Harrold* and *Denise Coal Company* held that the accrued liabilities of strip mining companies to restore the mined land to its original condition were deductible where the obligations to so restore the land arose from state legal requirements. In those cases, the applicable state laws

required the miner to restore the stripped land to its former condition. The taxpayers claimed deductions for the estimated costs of backfilling excavated lands as they stripped the land of coal even though the backfilling operations were not performed until the following year. The Comissioner denied the deduction contending there was no liability until the taxpayer incurred expenses to rehabilitate the land. As in the present case, the Commissioner urged the narrow view that a liability exists only when there is an obligation to presently pay money to an identifiable obligee. There was, however, no obligation to presently pay money to someone who had performed restoration work on the stripped land because the work had not yet been performed. The taxpayers contended that state law imposed an enforceable obligation to restore the land and the cost of restoration was measurable in dollars. The obligation to perform the restoration was the liability, and the operative event establishing the liability was the stripping of the land by the coal operation.

The accruals were allowed in the strip mining cases because in the taxable years in which the deductions were taken, all the operative facts had occurred resulting in the obligation to restore the stripped land. Similarly, in the present case, the Federal Circuit correctly held that the accrued deductions for progressive slot machine jackpots were allowable because in the taxable years in which the deductions were taken, the operative fact of liability had occurred when the progressive slot machines were operated on the casino floor, resulting in the obligation to pay the guaranteed jackpot at a future date.

Petitioner also conjectures that if the jackpot amounts represent fixed liabilities, there should be creditors en-

titled to claim such amounts (Pet. 8, 11). Because petitioner is unable to identify such purported creditors, it concludes that there is no fixed liability prior to the time a patron actually hits the winning combination (Pet. 11). Petitioner's analysis overlooks the fact that the Commission and the Board offer the opportunity to gaming establishments to operate progressive slot machines on the condition that the licensee agrees to abide by the applicable Gaming Regulations. At the time the licensee accepts the offer by placing progressive slot machines in operation, the gaming establishment becomes irrevocably obligated under the Gaming Regulations to pay the guaranteed jackpot at a future date. Accordingly, the obligees at such time are the gaming customers, and the Commission and the Board act as the representatives of such obligees.

To require the deduction of the progressive jackpot liability to be deferred until the year of actual payment as urged by petitioner, rather than the year in which the liability accrues, could wholly distort, rather than clearly reflect, respondent's taxable income. For example, the accrued liability on a particular machine may have progressed to a certain amount by the time a jackpot is won by a customer, with only a few dollars having been played in the machine and recognized as income in the year of payment but with substantial sums having been played and recognized as income in prior years. To require the jackpot to be deducted entirely in the year of payment would distort the taxable income for that year; whereas, the accounting method used by respondent results in the allocation of the expense to the years in which the revenues were earned.

CONCLUSION

Respondent's liability for its guaranteed jackpots satisfies the all events test because the Nevada Gaming Regulations, statutes, and policies impose the liability and because the amount of the liability is readily determinable at any time. In no event can the liability be cancelled by respondent. All events have occurred for proper accrual of the progressive slot machine jackpot liabilities. Accordingly, respondent has properly accrued and deducted the guaranteed jackpot liabilities in the year in which the amounts were registered on the progressive slot machines.

The Federal Circuit in this case and the Ninth Circuit in *Nightingale* purported to apply the same applicable tax law. However, the facts necessary to satisfy the all events test were determined differently by each court. For the reasons discussed above, respondent believes *Nightingale* is poorly reasoned and wrongly decided. The different conclusions reached by these courts concerning the operative facts do not, in any event, warrant review by this Court. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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APPENDIX

Section 1.446-1(c)(1)(ii) of the Treasury Regulations on Income Tax (26 C.F.R.) provides in pertinent part:

> (ii) *Accrual Method.* . . . Under such a method, deductions are allowable for the taxable year in which all the events have occurred which establish the fact of the liability giving rise to such deduction and the amount thereof can be determined with reasonable accuracy. The method used by the taxpayer in determining when income is to be accounted for will be acceptable if it accords with generally accepted accounting principles, is consistently used by the taxpayer from year to year, and is consistent with the Income Tax Regulations. . . .

Section 463.310 of the Nevada Revised Statutes provides in pertinent part:

> 1. The [Gaming Control Board] shall make appropriate investigations:
>
> (a) To determine whether there has been any violation of this chapter, chapter 464 or chapter 465 of NRS or any regulations adopted thereunder.
>
> (b) To determine any facts, conditions, practices or matters which it may deem necessary or proper to aid in the enforcement of any such law or rules and regulations.
>
> (c) To aid in adopting regulations.
>
> (d) To secure information as a basis for recommending legislation relating to this chapter, chapter 464 or chapter 465 of NRS.
>
> (e) As directed by the commission.

2. If, after any investigation the board is satisfied that a license, registration, finding of suitability, pari-mutuel license or prior approval by the commission of any transaction for which such approval was required or permitted under the provisions of this chapter or chapter 464 of NRS should be limited, conditioned, suspended or revoked, it shall initiate a hearing before the commission by filing a complaint with the commission in accordance with NRS 463.312 and transmit therewith a summary of evidence in its possession bearing on the matter and the transcript of testimony at any investigative hearing conducted by or on behalf of the board.

3. Upon receipt of the complaint of the board, the commission shall review it and all matter presented in support thereof, and, if satisfied that probable grounds exist for disciplinary or other action, shall conduct further proceedings in accordance with NRS 463.312. If the commission is not satisfied that probable grounds exist for disciplinary or other action, it may order the complaint withdrawn without prejudice to the filing of another complaint after further investigation and reconsideration by the board.

4. After the provisions of subsections 1, 2 and 3 above have been complied with, the commission may:

(a) Limit, condition, suspend, or revoke the license of any licensed gaming establishment or the individual license of any licensee without affecting the license of the establishment;

(b) Limit, condition, suspend or revoke any registration, finding of suitability, pari-mutuel license, or prior approval given or granted to any applicant by the commission;

(c) Order a licensed gaming establishment to keep an individual licensee from the premises of such licensed gaming establishment or not to pay such licensee any remuneration for services or any profits, income or accruals on his investment in such licensed gaming establishment; and

(d) Fine the licensee, registrant, person or entity previously found suitable, pari-mutuel licensee, or person or entity who previously obtained approval for any act or transaction for which commission approval was required or permitted under the provisions of this chapter or chapter 464 of NRS, not more than $100,000 for the first violation and not more than $250,000 for each subsequent violation of the provisions of this chapter, chapter 464 or chapter 465 of NRS or of the regulations of the commission. All fines shall be paid to the state treasurer for deposit in the general fund.

. . . .

Section 5.110 of the Nevada Gaming Regulations, as adopted in September 1972, provides:

1. This paragraph shall apply to any slot machine with a payoff indicator which has a payoff that increases as the machine is played.

2. No payoff indicator shall be turned back to a lesser amount, unless the amount by which the indicator has been turned back is actually paid to a winning player, or unless the change in the indicator reading is necessitated through a machine malfunction, in which case an explanation must be entered on the daily report as required in subsection 5.

3. If the payoff indicator progresses without a payoff until the indicators return to zero, some means must be utilized to add another digit, unless a dollar limit has been posted on the machine clearly visible to the player, and which was posted before any

payoff was registered on the indicator. When the limit has been reached it must be permitted to remain until won by a player.

4. Once a payoff amount appears on an indicator, the rate of progression may not be changed until there has been a winner, and the indicator is returned to zero.

5. Records shall be maintained which record the amount of the indicated payoff at least once per day. Supporting documents shall be maintained to explain any reduction in the payoff amount from the previous entry. Such records and documents shall be retained for a period of three years unless permission to destroy them earlier is given by the board in writing.

Section 5.110 of the Nevada Gaming Regulations, as amended March 1, 1977, provides:

1. *Applicability.* This regulation shall apply to any slot machine with a payoff indicator which has a payoff that increases as the machine is played.

2. *Limits.* A licensee may impose a limit on the jackpot of a progressive slot machine so long as the limit imposed is greater than the possible maximum jackpot payout showing on the machine at the time the limit is imposed. Progressive slot machines upon which a limit has been imposed by the licensee must have a sign posted predominately upon it informing the public of the limit imposed.

3. *Cash requirements.* Licensees who operates under a restricted license or who are classified as a Grop II nonrestricted licensee must maintain a minimum cash reserve equal to the total of all progressive slot machine jackpots which may be won at the location. Nonrestricted Group I gaming licensees shall at all times maintain sufficient cash or cash

equivalents to provide payment of all progressive jackpots offered to the public as prizes.

4. *Payoff indicators.* No payoff indicator shall be turned back to a lesser amount unless one of the following circumstances occur:

(a) The amount shown on the progressive meter is paid to a player as a jackpot; or

(b) It becomes necessary to adjust the progressive meter to prevent the jackpot indicator from displaying an amount greater than the limit imposed by the licensee pursuant to paragraph 2 of this regulation; or

(c) It becomes necessary to change the jackpot indicator because of machine malfunction, in which case an explanation must be entered on the daily report as required by paragraph 6 of this regulation.

5. *Payoff required.* Once a payoff amount appears on a jackpot indicator, the progressive meter may not be decreased except as allowed by this regulation. A progressive jackpot may be transferred to another progressive machine at the same location in the event of machine malfunction, replacement, or for other good reason. When the maximum jackpot limit is reached, it must be permitted to remain until won by a player.

6. *Records.* Records shall be maintained which record the amount shown on each progressive jackpot meter at least one time daily. Supporting documents shall be maintained to explain any reduction in the payoff amount from the previous entry. Such records and documents shall be retained for a period of five years unless permission to destroy them earlier is given by the board in writing.

7. *Effective date.* This regulation shall become effective on March 1, 1977, and shall apply to all licensees affected thereby who are then or thereafter licensed.